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TAGS: ECON EFIN VM FINREF
SUBJECT: VIETNAM ECONOMY IN THE FIRST HALF OF 2004 - STABLE GROWTH WITH MILD INFLATIONARY PRESSURE

REF: HANOI 1918

¶1. SUMMARY: The Vietnamese economy grew steadily at an annual rate of seven percent in the first six months of ¶2004. Nonetheless, the economy is facing increasing inflation primarily resulting from external supply factors. Boosted by higher oil prices, export performance remained strong with growth of 20 percent. Foreign direct investment has started a modest recovery after a two-year slowdown. The government response to inflation has ranged from raising the reserve ratio in banks to ordering government agencies to keep prices rises down. The former is a hopeful sign of a shift to more market-oriented policies while the latter is more a centralized planning approach. Other policies such as higher tariffs and taxes on automobiles have led to a sharp drop in sales for the fledgling auto market. The government may be getting some things right, but it is avoiding the hard issues such as financial sector and state-owned enterprise (SOE) reform while continuing to protect its services sectors. This is preventing foreign investment by cutting-edge firms that could bring better services at lower costs and create jobs. The question, as one foreign expert put it, is not how bad will inflation be this year, but whether Vietnam is growing at its potential. END SUMMARY.

GENERAL ECONOMIC PERFORMANCE

¶2. According to government estimates, Vietnam's Gross Domestic Product (GDP) grew by 7 percent in the first six months of 2004. This growth rate, at the same level compared to the first half of 2003, is behind the 7.5 - 8 percent target set by the National Assembly.

¶3. The growth rate of the agriculture, forestry and fishery sector rose by only 2 percent. Agriculture grew at 1.6 percent, the slowest rate of growth since 2000. This slow growth is due primarily to unfavorable weather conditions and avian flu. The northern region experienced a prolonged cold spell followed by a drought at the beginning of the winter-spring crop, and the southern central region experienced heavy rains. Avian flu also spread to many cities and provinces earlier in the year leading to massive culling of poultry stocks. Poultry farmers lost over 38 millions birds, 15 percent of the total stock.

¶4. The industry and construction sector grew by 10 percent, the same rate as in the first six months of 2003. Foreign invested enterprises and the domestic private sector were the primary contributors to the higher growth rates with growth of 14.7 percent and 21.8 percent respectively. Within the sector, the mining industry achieved the highest rate of growth at 15 percent, while other industries have experienced a slowdown. The construction industry, buffeted by rising steel prices in the first quarter, only grew at 7.3 percent compared to 10.6 percent for the same period last year.

¶5. The Consumer Price Index (CPI) has risen since December 2003 and has reached 7.2 percent in June 2004. This increase in CPI in the first half of 2004 was mainly driven by rising prices for food and foodstuff, which account for 47.9 percent of the price basket. The prices of food and foodstuff rose 13.2 percent, followed by pharmaceuticals and medical services (6.6 percent), and housing and building materials (4.8 percent). Rising world oil prices contributed slightly to the rising CPI, as transportation services account for 10.1 percent of the price basket.

¶6. In an effort to curb the increase of the CPI the State Bank of Vietnam (SBV) raised the compulsory reserve ratio to control credit growth and limit money supply. The IMF welcomed this step. The CPI continued rising in the third quarter but at a slower pace as a direct result of a more gradual rise in food prices. The CPI has increased 8.6 percent in the first nine months of 2004. The IMF forecast that annual inflation for 2004 would be around 9.5 percent, assuming no further supply shocks or other major changes for

the rest of the year. (See Reftel for more on Vietnam's inflation situation). More recently the GVN has instructed agencies to limit price increases.

¶7. The Vietnamese Dong depreciated only 2 percent against the U.S. Dollar in the first half of the year. Two trends were apparent. There was a rise in USD remittances from overseas. There was also a shift in personal savings from USD to VND in the local banking system in pursuit of higher interest rates. Dong deposit rates range from 7.5-8.5 percent per annum versus 1.9 to 2.1 percent for dollars held locally. Some State Bank officials urged Vietnamese to keep their personal savings in Dong, apparently arguing that this would give a higher income, despite the fact that real income would be negative. These factors do not explain the limited depreciation of the Dong as much as the narrow band that limits daily fluctuation of the Dong (under three percent from the previous day's close) does.

¶8. Overseas remittances by Vietnamese residents and Vietnamese workers have been rising steadily. A State Bank official estimated that total remittance to Vietnam may reach USD 3 billion this year, surpassing the record figure USD 2.5 billion in 2003. The IMF estimates that an additional USD 3-4 billion enters the country through informal channels.

FOREIGN DIRECT INVESTMENT

¶9. In the first six months of 2004, 280 foreign direct investment (FDI) projects were licensed with a total investment capital of USD 806.6 million. The number of new projects stood at the same level compared to the same period last year, but the registered capital increased by 13.6 percent, with the increase in average registered capital per project from USD 2.5 million in 2003 to USD 2.88 million in the first half of 2004. New projects continued to concentrate in the industry and construction sector with 71.8 percent of new projects (201 projects), and 59.5 percent of the total registered capital (USD 479.6 million).

¶10. The southern region remains the most attractive location to foreign investors with 199 projects worth USD 454.7 million, accounting for 71.1 percent of the total number of new projects and 56.4 percent of the total registered capital.

¶11. Among foreign investors, Taiwan, with 65 projects worth USD 231 million, accounts for 28.6 percent of the total registered capital and was the largest foreign investor in the first six months 2004. Taiwan is followed by Canada, South Korea, Malaysia, and Japan. Due to a large investment project this year (USD 147 million) Canada, ranked in the top ten foreign investors. Since the GVN continues to include only direct U.S. investment and ignore U.S. investment through third country subsidiaries in its official statistics, the total for the United States appears lower than it really is.

¶12. Although Vietnam's investment climate has improved considerably, there are still many issues to be ironed out. The investment evaluation and licensing process is in practice lengthier than stipulated. Site clearance and land lease procedures often delay project deployment. Regulations on foreign investment are sometimes vague and inconsistent.
¶13. The GVN has stated publicly that it recognizes the importance of foreign investment to economic growth and is aware of increasing competition in the region for foreign investment. In seeking to boost foreign investment levels from the recent slump, the GVN is working to formulate an adequate common legal framework for both foreign and domestic investors. The GVN has also pledged to facilitate foreign investment in essential areas such as real estate, financial services, aviation, marine transportation, legal services, telecommunications and trade.

TRADE

¶14. Exports continued to be strong in the first half of 2004, generating USD 11.8 billion and maintaining steady growth at 20 percent compared to the same period last year.

Top ten export products in 1H/2004

Name	Value (USD mil)	Percent of total exports
1 Crude Oil	2,501	21.2
2 Textile & Garment	1,996	16.9
3 Footwear	1,290	10.9
4 Aquatic products	982	8.3
5 Rice	506	4.2
6 Wooden products	492	4.2
7 Electronic products, computers	405	3.4

8	Coffee	360	3.0
9	Handicraft Rubber	194	1.6
10	Power conduit & cable	168	1.4

Source: General Statistics Office

¶15. Crude oil was the main contributor to export growth, earning USD 2.5 billion and recording a 29.3 percent growth. This was the combined result of increases in both export volume and oil prices. Other significant contributors to export growth included: footwear, rice, wooden products, coffee and power cables.

¶16. Textile and garment exports generated nearly USD 2 billion in the first half of 2004, a 7.8 percent increase compared to the same period in 2003. Also in the first half of 2004, textile exports to the European Union, Canada and Japan surged dramatically (53.8 percent, 17.9 percent and 10.2 percent respectively) offsetting the reduction of these exports to other markets such as the United States, ASEAN, and South Korea. (Note: The U.S.-Vietnam Bilateral Textile Agreement took effect in May 2003, capping growth of Vietnamese textile and garment exports to the United States. End Note.)

¶17. Traditional key export commodities such as rice, coffee and coal have gone up significantly as a direct result of recovered or rising prices. Rice exports were down by 3.3 percent in volume but up 14.5 percent in value thanks to improved quality and higher prices. (Note: the price of rice went up by USD 35 per ton compared to the same period last year. End Note.) Coal and coffee exports also increased sharply in both quantity and value (48.8 percent and 59.9 percent respectively for coal, 52.5 percent and 46 percent respectively for coffee). These helped maintain high export growth. This year wooden products are emerging as Vietnam's new major export, earning nearly USD 500 million in income in the first six months.

¶18. According to analysis by the GVN, exports are maintaining a high growth rate for several reasons. First, some products achieved a higher export volume (namely crude oil, coal, coffee, tea). The world economy is recovering and the prices of some commodities (e.g.: crude oil, rice, coal, rubber) were rising. Finally, the government of Vietnam and concerned agencies were active in expanding export markets and promoting exports.

Top ten import products for 1H/2004

	Name	Value (USD mil)	Percent of total import
1	Machinery & equipment	2,093	14.7
2	Petroleum products	1,588	11.2
3	Leather, textiles, garments	1,174	8.3
4	Steel & iron	1,111	7.8
5	Cloth	1,019	7.2
6	Electronic products, computers and components	549	3.9
7	Plastic	496	3.5
8	Fertilizer	346	2.4
9	Automobile	344	2.4
10	Chemical products	336	2.3

Source: GSO

¶19. Imports reached USD 14.2 billion, and rose 14.7 percent compared to last year. The domestic sector spent USD 9.1 billion (64 percent of total import value), up 12.8 percent from last year, and foreign invested enterprises (FIEs) imported USD 5.1 billion (36 percent of total import value), up 18.2 percent from last year.

¶20. As a result of rising prices of some products such as petroleum, steel, fertilizer and plastic, the import value of these products increased considerably even though import volumes rose only modestly or even declined. For example, petroleum imports grew only 5 percent in volume but rose 25.6 percent in value due to a 20 percent increase in price, while steel and iron decreased 0.7 percent in volume but rose 21.3 percent in value due to a 22 percent increase in price.

¶21. Machinery and equipment imports dropped 17.6 percent compared to the same period last year. The 2003 level was particularly high as a result of a surge in imports of machinery and equipment for the Southeast Asia (SEA) Games XXII. The import of auto parts and kits for local assembly decreased in the first half of 2004. A five-fold increase in the Special Consumption Tax on autos, from 5 percent to 25 percent (effective from 1 January 2004) resulted in an over 20 percent increase in the sales prices of locally assembled vehicles, slowing sales.

¶22. The trade deficit in the first six months of 2004 stood at the same level in value compared to the same period in

¶2003. However, as a percentage of total export income the trade deficit was down to 20 percent from 24.3 percent. The domestic sector had a trade deficit of USD 3.7 billion while foreign invested enterprises (including crude oil exporters) reported a trade surplus of USD 1.3 billion. Excluding crude oil the foreign invested sector had a trade deficit of USD 1.1 billion.

Vietnam-US trade for 1999 - 2003 (In USD million)

	2001	2002	2003
Exports to US (US customs value)	1,053	2,395	4,555
Imports from US (US FAS value)	461	580	1,324
Trade balance	592	1,815	3,231

Source: US International Trade Commission

¶23. Vietnam's exports to the United States continued to grow, generating nearly USD 2.4 billion in the first six months of 2004. Major export merchandises with high growth included footwear, wooden products (furniture), fruits and nuts and garments. However, Vietnam's imports from the United States dropped to USD 339 million from USD 670 million, due mainly to a difference in aircraft sales in
¶2004. This resulted in Vietnam's widened trade surplus with the United States, to over USD 2 billion in the first half of 2004. Excluding aircraft sales, however, U.S. exports to Vietnam grew 6 percent in the first of 2004, with strong growth in exports of cotton, electrical machinery, plastics, wood and paper.

¶24. COMMENT: Benefiting from higher export earnings from oil and largely insulated from domestic oil price rises, Vietnam's steady growth continued. The local headline is and continues to be inflation from external supply shocks in the food and foodstuffs that comprise half of the CPI basket. The government response has ranged from raising the compulsory reserve ratio in banks to ordering government agencies to keep prices rises down. The former is a hopeful sign of a shift to more market-oriented policies while the latter is more of a centralized planning approach. There have been rumors that the government may revise the market basket to reduce the share of foodstuff and with it inflation. Other policies such as higher tariffs on automobile kits for assembly and higher taxes on their finished products have caused a sharp drop in sales in the fledgling auto market that has already led Toyota to layoffs and threatens the investments of major auto makers.

¶25. While the government may be getting some things right, it is avoiding the hard issues such as financial sector and SOE reform while continuing to protect its services sectors. This is preventing foreign investment by cutting-edge firms that could bring better services at lower costs and create jobs. For example, there were no FDI projects in the banking and finance sector licensed in the first half of the year. The question, as one foreign expert recently put it, is not how bad will inflation be this year, but whether Vietnam is growing at its potential. End Comment.

MARINE